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DE RUEHB^J #1438/01 0640820
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FM AMEMBASSY BEIJING
TO RUEHC/SECSTATE WASHDC PRIORITY 5274
INFO RUEHOO/CHINA POSTS COLLECTIVE
RUCPDOC/USDOC WASHDC
RHMFSS/DEPT OF ENERGY WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RHEHNSC/NSC WASHDC

C O N F I D E N T I A L SECTION 01 OF 06 BEIJING 001438

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DOE FOR ASSISTANT SECRETARY HARBERT
DOE FOR PUMPHREY
STATE PASS CEA/BLOCK
STATE PASS CEQ/CONNAUGHTON
STATE PASS EPA FOR OIA/AYRES, FIDLER AND MCASKILL
STATE PASS USTR FOR STRATFORD, ALTBACH, WINTER, CELICO
STATE ALSO FOR INR/B
STATE ALSO FOR OES/WATSON AND DEROSA-JOYNT
TREASURY FOR OASIA/ISA DOHNER, HAARSAGER, BAKER, CUSHMAN
TREASURY FOR DEPUTY CHIEF OF STAFF TAIYA SMITH
USDOC FOR ITA DAS KASOFF
USDOC FOR ITA/MAC/OCEA/MCQUEEN

E.O. 12958: DECL: 03/05/2017

TAGS: ENRG EPET EINV ETTC PGOV CH IR

SUBJECT: NDRC VICE CHAIRMAN ZHANG GUOBIAO: CHAMPION OF ENERGY, CONCERNED ABOUT FOREIGN INVESTMENT, ANGRY ABOUT CNOOC AND ILSA

Classified By: AMBASSADOR CLARK T. RANDT, JR., REASONS 1.4 (B) AND (D)

¶1. (C) Summary. National Development and Reform Commission (NDRC) Vice Chairman Zhang Guobao outlined China's growth in energy consumption and plans for expansion of production of a variety of energy sources at a luncheon hosted by the Ambassador on February 8. Zhang expressed his bureaucratic preference that bilateral discussion of energy issues be conducted in the Energy Policy Dialogue and not in the Strategic Economic Dialogue, which he feels involves too much cumbersome coordination with many other agencies. In response to the Ambassador's reiteration of concerns about expanding business links with Iran after UNSC Resolution 1737 and when Iran is pursuing nuclear programs in contravention of the international community's will, Zhang said China is fully aware of U.S. concerns, but heatedly added that the UNSC Resolution does not specifically address trade in oil and natural gas. If the United States would not allow CNOOC to purchase UNOCAL, will not itself guarantee China a steady energy supply and opposes Chinese purchases of Iranian oil and gas, how can China survive? he queried.

¶2. (C) Zhang said no decision has yet been taken on the timing and location of the next Five-Party Energy Ministerial. Chinese agencies are developing review procedures for screening foreign investment in China. Zhang explained four recent cases in which foreign investments had drawn opposition from Chinese agencies. He described the Ministry of Commerce's 2006 merger and acquisition regulation as uncoordinated with other agencies. Zhang is concerned about Chinese imports of equipment and claims success in his responsibilities not only for energy matters but also for revitalization of China's Northeast. In reply to a question about possible formation of a Chinese Ministry of Energy, Zhang said he runs energy policy with a staff of less than sixty at the NDRC. End summary.

China's Energy Mix

¶3. (SBU) In response to the Ambassador's several questions on the energy mix in China, Vice Chairman Zhang extolled the growth of Chinese energy production that has occurred while he has held the energy portfolio at the NDRC. (Not once did he mention fellow NDRC Vice Chairman Chen Deming, who was reported in the Chinese press in 2006 to be taking charge of some energy issues.) China is constructing its first liquefied natural gas terminal in Guangdong, with a capacity of 3.5 million tons per year, which will handle LNG from Australia. Financial resources for construction of two more LNG terminals are now being allocated. One in Fujian Province, to be supplied with LNG from Indonesia, will have an annual capacity of 2.5 million tons, and another is to be built in Shanghai. Malaysian LNG will go to the Shanghai terminal, which will have an annual capacity of one million tons. Many more LNG terminals are planned but not yet funded.

¶4. (SBU) Embassy DOE Executive Director followed up with questions on the role of nuclear power in China's energy mix, noting that some projections show the nuclear share as unlikely to rise significantly. Nuclear power now accounts for 1.6 percent of China's total energy production, Vice Chairman Zhang replied. Total installed power production capacity at the end of 2006 stood at 600 gigawatts, of which nuclear power production capacity is 2.7 gigawatts. China hopes to raise the nuclear power portion of the total energy production mix to 4 percent by 2020. To reach that 2020 goal, China will need to construct four nuclear power plants per year. Time, not investment, is the constraint on reaching that goal. Good energy projects in China have willing Chinese and foreign investors to fund them. Chinese banks now hold 33 trillion renminbi in savings deposits, while Chinese banks' loans to enterprises only amount to 22

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trillion renminbi. So 11 trillion renminbi is available to be loaned out, and China's foreign exchange reserves are now about USD one trillion. Westinghouse's AP-1000 technology has not been implemented before. Many Chinese officials say that the AP-1000 must be tested and seen to work before building more nuclear power plants using that technology. French nuclear technology used in Guangdong Province will also be used for more nuclear power plants to be built before ¶2013.

¶5. (SBU) In response to the Ambassador's questions on hydroelectric power and the Three Gorges Project, Zhang said the Three Gorges Hydroelectric Project will be completed and fully operational in 2013. The power generating capacity of that project now is only completed on the river's "left bank," where 14 generators are installed. Twelve more are yet to be installed at that project. The water level behind the Three Gorges dam now stands at 156 meters but will further rise to 178 meters in the coming years. Zhang highlighted his role in promoting construction of additional hydroelectric production capacity. China has recently launched two projects on the Jinsha River with power production capacities larger than that of the Three Gorges Project: the Xiluodu Project, on which construction began in December 2005; and the Sanjiaba Project, on which construction began in October 2006. The production capacity of hydroelectric projects now under construction in China is greater than 90 gigawatts.

¶6. (SBU) Zhang claimed that when he took on responsibilities for energy issues, China lacked even one natural gas pipeline. Zhang said he led work on the West-to-East gas transmission line, with nearly 4000 kilometers completed. Two more gas transmission lines are under construction. The West-to-East pipeline crosses eight provinces, the Yellow River three times and the Yangtze once, highways, railroads and even the Great Wall. Zhang had led a national leading group on construction of the West-to-East Pipeline, the deputy for which when established had been the

deputy chairman in the Xinjiang Autonomous Region, later transferred to Liaoning Province. When construction problems arose, the leading group would be convened. Leading group members have been willing to see China have a powerful energy network, and despite the many difficulties in undertaking such a large project, local governments gave Zhang and the leading group their complete help. He recounted his own insistence that a redundant power supply be connected to safeguard workers in a two-kilometer pipeline tunnel under the Yangtze, to which the local governments had complied without hindrance.

Bilateral Cooperation on Westinghouse

¶ 17. (C) Noting the great increase in Chinese coal production and consumption during his career, and increased media attention to the issue of global warming, Vice Chairman Zhang said China should not burn fossil fuels in such large quantities. First, the coal will one day be exhausted. Second, it is more realistic to rely on expanding nuclear power and wind power generation, areas where China and the United States can have important cooperative efforts. Finalizing bilateral nuclear power cooperation will still require hard work. China will place requirements on Chinese companies in this field, and will expect that the United States will likewise place requirements on Westinghouse. Zhang downplayed the difficulties of addressing the nuclear power equipment supplier liability issue and emphasized finalizing cooperation arrangements. Conducting nuclear power cooperation within the signed framework should be smooth. China aims for a May Westinghouse contract signing. The first AP-1000 nuclear power plant in China would go on line by 2013.

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Biomass and UNOCAL

¶ 18. (C) Vice Chairman Zhang also cited biomass fuel as an area of great potential for bilateral cooperation. Corn that is currently used for ethanol production is also needed for animal feed. Our two nations should work to develop ethanol production from cellulose. While there are many opportunities to cooperate in oil and gas projects worldwide, some in the United States must change their views about China. There are some in the United States who believe China is trying to monopolize natural resources, so they oppose China's globalization. Had CNOOC been allowed to purchase UNOCAL, United States interests would not have been damaged. The United States has other oil companies and should promote more cooperation between them and China.

Zhang Against Mixing Energy with the SED

¶ 19. (C) The Ambassador asked for Zhang's views on the energy component within the Strategic Economic Dialogue (SED). Energy is a significant component of the SED, but the current structure of the SED focuses mainly on macroeconomic issues like currency, investment and securities, Zhang replied. The SED is led by the United States Treasury Department and the Chinese Ministry of Finance, and the Ministry of Finance is not involved in energy issues. The Treasury Department is much more powerful with a much greater scope of influence than the Ministry of Finance. There is no United States equivalent to the NDRC. Putting energy issues in the SED makes it more difficult to manage energy issues in China, because of the need for considerable work on internal coordination. Zhang held that energy issues should be in a mechanism separate from the SED and recommended the existing NDRC-DOE Energy Policy Dialogue as the appropriate locus for bilateral energy policy work. The Ambassador explained to Zhang Secretary Paulson's role in the SED is in his capacity as the President's Special Representative and not in his capacity as Treasury Secretary. Secretary Bodman of DOE participates in the SED to address energy issues.

Zhang Says Iranian Oil Needed

¶10. (C) The Ambassador stressed our concerns about nations embarking in major new business initiatives with Iran after UNSC Resolution 1737 and when that country is moving against the views of the international community with respect to its nuclear program. Zhang replied that China joins the international community in opposing Iranian acquisition of nuclear weapons, which would have no benefit to the world. China is very strict in complying with the UNSC Resolution on Iran. But, Zhang continued, that UNSC Resolution does not specifically cover the oil and natural gas sectors. China will not sell weapons or provide materials for making nuclear weapons to Iran. Many other countries conduct business in the Iranian oil and gas sectors. China purchases about 14 million tons of oil from Iran per year, some of it directly but much of it through international oil companies, such as France's Total.

¶11. (C) Zhang recalled that the Embassy has demarched NDRC several times to register opposition to possible expansion of Chinese involvement in Iran's energy sector. He further recalled that the NDRC has asked if the United States wishes to block Chinese purchases from Iran, would the United States instead commit to supply oil and gas to China? China tried to purchase UNOCAL, but the purchase was blocked by the United States. The United States won't let China deal with friends (meaning the United States) nor with its enemies (meaning Iran), so how can China survive? Iran has the world's second largest oil reserves, but if China is forced to obtain all of its oil imports from other sources, world oil prices would increase and possibly even double, Zhang vexedly alleged. That price consideration is why the UNSC

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Resolution ultimately did not cover oil and gas trade, Zhang claimed. A/EconMinCouns informed Zhang that multiple nations are the recipients of our demarches on the Iranian oil and gas sector and that China has not been singled out for its investments in Iran.

Next Five-Party Energy Ministerial

¶12. (C) The Ambassador congratulated NDRC for successfully convening the December 2006 Five Party Energy Ministerial in Beijing (China, the United States, India, South Korea and Japan participated). Vice Chairman Zhang claimed credit for initiating the idea of having five big energy-consuming nations meet. He noted that Premier Wen Jiabao had met the delegations and recommended that they meet again periodically, making it into a regular mechanism to exchange views on international energy issues. Thus, the Five Party Energy Ministerial is now aimed at annual meetings, though the location and date of the next meeting has not been set. Zhang noted that Vice Premier Wu Yi would be leading China's Strategic Economic Delegation to Washington in May.

Gas Prices Fuel Domestic Pressures on NDRC

¶13. (C) The Ambassador asked how it was that the NDRC had recently decreased domestic prices for gasoline and other fuels. Zhang said consumers don't like high prices. Domestic price increases for gasoline and other products in 2006 had not kept pace with the increase in international oil prices. While Chinese oil refiners lost money, Chinese consumers also complained about the price increases. Consumer anger has been directed at NDRC price setters and China's monopoly oil companies. Consumers saw that international oil prices had decreased from 2006 highs and asked why prices of products in China had not. The consumer asked, was the NDRC only in charge of price increases, but not price decreases? Zhang said the NDRC could not tolerate this public pressure and recently implemented a slight decrease in domestic prices. But since then, international oil prices have increased. Chinese oil refiners continue to lose money, with one refiner in Liaoning losing RMB 14

billion over the last year. The National People's Congress will meet soon (March 2007), and consumers will not welcome an increase in the price of oil products.

Small But Superb Energy Bureaucracy in China

¶14. (C) Vice Chairman Zhang expressed pride in the efficiency and talents of the very few Chinese officials who set energy policy. They number less than sixty persons and report to Zhang. He contrasted the current situation to that of earlier decades, when China had separate ministries for coal, petroleum and electric power. He touted China's accomplishment in linking six different parts of the country on a national power grid during his career, and the increase in China's installed power capacity from about 58 gigawatts in 1978 to about 600 gigawatts now. The fewer than sixty officials are of high quality, work hard and long and uncomplainingly, and do not ask for raises. Zhang said he does his best to try to meet his subordinates' demands for promotions. He cited Energy Bureau Deputy Director General Zhang Yuqing as a star who has risen from Deputy Division Director to his current position. (DDG Zhang beamed and said he and his colleagues work very, very hard.)

Concerns about Foreign Direct Investment in China

¶15. (C) The Ambassador's questions about recent press reports on NDRC concerns about equipment imports and revisions to China's guidelines for foreign investors prompted lengthy comments from Vice Chairman Zhang. First, Zhang said, he is not only in charge of energy issues, but the NDRC's Industry Department also reports to him. The

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Industry Department has responsibilities for the iron and steel, automotive, petrochemical, shipbuilding, textile and other heavy and light industrial sectors (but not for services industries). Chinese agencies have recently discussed standardization of investments by foreigners in China's machinery manufacturing sector. Those discussions were prompted first by Carlyle's attempt to buy Xugong, but also driven by Alstom's investment in an Wuhan boilermaker, a German company's purchase of a company in Luoyang, and Caterpillar's attempt to buy Xiamen Engineering and Equipment. China has seen a great increase in foreign interest in the machinery manufacturing sector, leading to concerns that all Chinese companies in the sector will be acquired by foreign companies. When a Chinese company cannot buy a United States oil and gas company, UNOCAL, because of U.S. Congressional concerns, why should foreign companies be allowed to buy Chinese companies without undergoing an examination procedure?

¶16. (C) China is now working to establish an investment examination committee, Zhang explained. Before that process had been completed, however, the Ministry of Commerce (MOFCOM) issued its merger and acquisition guidelines, clearing it with some other agencies, but not with the NDRC. The MOFCOM guidelines have no operational mechanism for implementation, Zhang claimed. Now, MOFCOM and NDRC are discussing investment examination issues, but no conclusions have been reached. Zhang posited that evaluation of whether a foreign acquisition of a Chinese company will be judged good or bad will rest with both NDRC and MOFCOM.

¶17. (C) Zhang noted that the interagency Committee on Foreign Investment in the United States (CFIUS) has many member agencies, inferring that China's future analogous body will also have many members. (Note: In an SED-related Investment Dialogue meeting in Beijing on January 29, the following Chinese agencies participated: MOFCOM, Ministry of Finance, State Environmental Protection Agency, People's Bank of China, NDRC, State Council Legislative Affairs Office, Ministry of Foreign Affairs, and Ministry of Labor and Social Security. End note.)

¶18. (C) Zhang said factors that Chinese agencies are likely to consider will include whether the investment will create a monopoly; whether the acquisition target in China has unique technologies; and whether the Chinese company is a strong competitor in the world, such that acquisition of the Chinese company would reduce competition faced by the acquiring foreign company. Foreigners trying to get rid of a competitive threat by acquisition will be opposed. But to date the standards for investment examination have not been agreed. United States Congressional opposition to CNOOC's attempted purchase of UNOCAL will have many aftereffects, Zhang continued. Zhang said he told CNOOC to proceed with its offer for UNOCAL after being informed that important consultants in the United States had not foreseen problems. He added that the timing of CNOOC's offer was delayed by initial opposition from two independent members of CNOOC's board of directors.

¶19. (C) The Ambassador reminded Zhang of United States perceptions that some Chinese companies remain state-owned enterprises or parastatal entities, not necessarily independently in control of their business decisions. Zhang countered that China is open to foreign participation in its oil and gas sector. Chinese do not claim that those companies' presence in China poses a national security threat. While acknowledging that large United States companies are not government-owned companies, Zhang stressed that big Chinese companies have undergone big changes and state-owned enterprise reform continues. CNOOC itself is listed on the New York and Hong Kong stock exchanges.

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Northeast Revitalization

¶20. (SBU) The Ambassador also inquired about Zhang's responsibilities for revitalization of China's Northeast. Zhang said he had visited China's Northeast from February 2 through 6, accompanying Wu Bangguo, head of the National People's Congress. Zhang had last visited the Northeast in August of 2004. He was surprised to see the positive changes that have occurred already. Still, the Northeast's difficulties and challenges remain large. Two million forestry workers are in the Northeast, and there are new pressures to preserve forests. Their employment future is uncertain. The Northeast is also home to five million coal miners, who have difficult livelihoods.

Comment: Zhang Still Stings From CNOOC

¶21. (C) This was the frankest and most direct we have heard Zhang on the fact that he approved CNOOC's bid for UNOCAL. Zhang, who clearly relishes his reputation for success, would appear to still feel the sting of that very public failure.

Seeks Alternative to Iran

¶22. (C) On Iran, Zhang hit hard again on a theme he has hit before -- China needs Iran's oil and, if sanctions cut that oil off, China seeks alternate sources. Zhang and his NDRC colleagues continue to hope that the United States will sit down with them and discuss how to handle the consequences of sanctions on Iran. End comment.

Biographical Note

¶23. (C) Zhang had little need for interpretation from English to Chinese for our questions and comments in English, only occasionally asking for clarification in Chinese of those questions or comments before replying. He replied in Chinese, using a translator. Only once when he did not ask for clarification or interpretation before replying did he fail to understand a question. He and NDRC Foreign Affairs Deputy DG Li Bin spoke about the Vice Chairman's skill as a photographer and as a humorous raconteur. Zhang also confided that when he finds himself in boring meetings that

he cannot leave, he actually writes poetry rather than taking notes of the proceedings. He said meetings which he himself chairs can range from two minutes to an hour in length and took pride in noting that he often will depart meetings immediately after he has had his say and that he differed from other Chinese officials in this regard.

124. (U) Participants:

NDRC Vice Chairman Zhang Guobao

NDRC Energy Bureau Deputy Director General Zhang Yuqing

NDRC Foreign Affairs Deputy Director General Li Bin

NDRC Foreign Affairs Department Interpreter Ms. Li Chao

The Ambassador

DOE Beijing Executive Director Dr. Marco DiCapua

Acting Economic Minister-Counselor Christopher Beede

(notetaker)

Language Officer James Brown

RANDT